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## MOMENTUM OF ACCELERATED CAPITAL

ECONOFICTION CAPITAL, DERIVATE, FINANCE, HIGH-FREQUENCY-TRADING

Distinct types of high frequency trading firms include independent proprietary firms, which use private funds and specific strategies which remain secretive, and may act as market makers generating automatic buy and sell orders continuously throughout the day. Broker-dealer proprietary desks are part of traditional broker-dealer firms but are not related to their client business, and are operated by the largest investment banks. Thirdly hedge funds focus on complex statistical arbitrage, taking advantage of pricing inefficiencies between asset classes and securities.

Today strategies using algorithmic trading and High Frequency Trading play a central role on financial exchanges, alternative markets, and banks' internalized (over-the-counter) dealings:

High frequency traders typically act in a proprietary capacity, making use of a number of strategies and generating a very large number of trades every single day. They leverage technology and algorithms from end-to-end of the investment chain – from market data analysis and the operation of a specific trading strategy to the generation, routing, and execution of orders and trades. What differentiates HFT from algorithmic trading is the high frequency turnover of positions as well as its implicit reliance on ultra-low latency connection and speed of the system.

The use of algorithms in computerised exchange trading has experienced a long evolution with the increasing digitalisation of exchanges:

Over time, algorithms have continuously evolved: while initial first-generation algorithms – fairly simple in their goals and logic – were pure trade execution algos, second-generation algorithms – strategy implementation algos – have become much more sophisticated and are typically used to produce own trading signals which are then executed by trade execution algos. Third-generation algorithms include intelligent logic that learns from market activity and adjusts the trading strategy of the order based on what the algorithm perceives is happening in the market. HFT is not a strategy *per se*, but rather a technologically more advanced method of implementing particular trading strategies. The objective of HFT strategies is to seek to benefit from market liquidity imbalances or other short-term pricing inefficiencies.

While algorithms are employed by most traders in contemporary markets, the intense focus on speed and the momentary holding periods are the unique practices of the high frequency traders. As the defence of high frequency trading is built around the principles that it increases liquidity, narrows spreads, and improves market efficiency, the high number of trades made by HFT traders results in greater liquidity in the market. Algorithmic trading has resulted in the prices of securities being updated more quickly with more competitive bid-ask prices, and narrowing spreads. Finally HFT enables prices to reflect information more quickly and accurately, ensuring accurate pricing at smaller time intervals. But there are critical differences between high frequency traders and traditional market makers:

1. HFT do not have an affirmative market making obligation, that is they are not obliged to provide liquidity by constantly displaying two sides quotes, which may translate into a lack of liquidity during volatile conditions.
2. HFT contribute little market depth due to the marginal size of their quotes, which may result in larger orders having to transact with many small orders, and this may impact on overall transaction costs.
3. HFT quotes are barely accessible due to the extremely short duration for which the liquidity is available when orders are cancelled within milliseconds.

Besides the shallowness of the HFT contribution to liquidity, are the real fears of how HFT can compound and magnify risk by the rapidity of its actions:

There is evidence that high-frequency algorithmic trading also has some positive benefits for investors by narrowing spreads – the difference between the price at which a buyer is willing to purchase a financial instrument and the price at which a seller is willing to sell it – and by increasing liquidity at each decimal point. However, a major issue for regulators and policymakers is the extent to which high-frequency trading, unfiltered sponsored access, and co-location amplify risks, including systemic risk, by increasing the speed at which trading errors or fraudulent trades can occur.

Although there have always been occasional trading errors and episodic volatility spikes in markets, the speed, automation and interconnectedness of today's markets create a different scale of risk. These risks demand that exchanges and market participants employ effective quality management systems and sophisticated risk mitigation controls adapted to these new dynamics in order to protect against potential threats to market stability arising from technology malfunctions or episodic illiquidity. However, there are more deliberate aspects of HFT strategies which may present serious problems for market structure and functioning, and where conduct may be illegal, for example in order anticipation seeks to ascertain the existence of large buyers or sellers in the marketplace and then to trade ahead of those buyers and sellers in anticipation that their large orders will move market prices. A momentum strategy involves initiating a series of orders and trades in an attempt to ignite a rapid price move. HFT strategies can resemble traditional forms of market manipulation that violate the **Exchange Act**:

1. Spoofing and layering occurs when traders create a false appearance of market activity by entering multiple non-*bona fide* orders on one side of the market at increasing or decreasing prices in order to induce others to buy or sell the stock at a price altered by the bogus orders.
2. Painting the tape involves placing successive small amount of buy orders at increasing prices in order to stimulate increased demand.
3. Quote Stuffing and price fade are additional HFT dubious practices: quote stuffing is a practice that floods the market with huge numbers of orders and cancellations in rapid succession which may generate buying or selling interest, or compromise the trading position of other market participants. Order or price fade involves the rapid cancellation of orders in response to other trades.

The **World Federation of Exchanges** insists: — Exchanges are committed to protecting market stability and promoting orderly markets, and understand that a robust and resilient risk control framework adapted to today's high speed markets, is a cornerstone of enhancing investor confidence. However this robust and resilient risk control framework' seems lacking, including in the dark pools now established for trading that were initially proposed as safer than the open market.

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